

# Fiscal Note

*Fiscal Services Division*



---

**HF 2454** – Innovation Fund Tax Credits (LSB 6027HZ.1)

Analyst: Jeff Robinson (Phone: 515-281-4614) ([jeff.robinson@legis.state.ia.us](mailto:jeff.robinson@legis.state.ia.us))

Fiscal Note Version – New

---

## **Description**

**House File 2454** modifies the current tax credit for qualified equity investments in the Iowa Innovation Fund by removing the requirement that the tax credit equal to 20.0% of the investment. The Bill also makes the tax credits transferable. Under current law, and under the Bill, annual tax credits are limited to a total of \$8.0 million and the tax credits may not be redeemed until the third year after the qualifying investment is made. The Bill is effective on enactment and retroactive to January 1, 2012.

## **Background**

The Innovation Fund was created in **SF 517** (Economic Development Appropriations Act) during the 2011 Legislative Session. The Innovation Fund is one or more early-stage capital funds certified by the Iowa Economic Development Authority (IEDA) Board. The 20.0% tax credit for equity investments in the Innovation Fund was also created in SF 517.

The tax credit cannot be redeemed until the third tax year after the tax year in which the qualified investment was made. Under current law, the tax credits are not refundable or transferrable, but unused credits may be carried forward for up to five additional tax years.

The IEDA is required to allocate \$8.0 million of its annual \$120.0 million tax credit cap to the Innovation Fund, starting in FY 2012 (see **Iowa Code section 15.119**). The IEDA cannot allocate unused Innovation Fund credits to other programs that also exist under the \$120.0 million cap.

Taxpayers that invest in the Innovation Fund likely receive equity interest in the Fund. Under the provisions of the Bill, they will also receive a State income tax credit equal to 100.0% of their investment, but the credit cannot be redeemed for at least three years. Taxpayers may also face higher federal tax bills if the State income tax reduction they earn through the investment tax credit increases their federal tax liability. State income taxes are deductible at the federal level for itemized individual income tax filers and are business deductions for businesses; both instances potentially increase federal income taxes owed.

At the current 20.0% tax credit rate, the Innovation Fund could generate \$40.0 million per year if the \$8.0 million tax credit was fully utilized. If the tax credit is increased to 100.0%, the annual tax credit limit would net \$8.0 million in Innovation Fund investments each year.

The IEDA rules for the Innovation Fund tax credit specify that if valid applications for more than the \$8.0 million available in a year are received, the Department will prioritize tax credit awards in the next year so that the excess applications receive tax credits first.

## **Fiscal Impact**

The current 20.0% tax credit has been in place for eight months. Over that time, it does not appear that much progress has been made in attracting investment or creating an Innovation Fund. Therefore, it is not possible to assess whether the current \$8.0 million allocation with a 20.0% tax credit for Innovation Fund investments will be utilized in part or in whole, during FY 2012 or after, although the possibility exists that the program will not be utilized unless that tax credit is enhanced.

Increasing the existing tax credit from 20.0% of the amount invested to 100.0% will no doubt make the investment more attractive and will therefore make it more likely that the \$8.0 million annual cap will be utilized. However, at this early stage of the new program, it is not possible to conclude the existing Innovation Fund concept will not work, so the increase in the tax credit percentage from 20.0% to 100.0% does not have a fiscal impact.

The changes in the Bill will allow investment tax credits of any percentage up to 100.0%. At 100.0%, the tax credit percentage change would mean that the annual \$8.0 million State General Fund investment in financing the Innovation Fund will yield \$8.0 million per year for the Fund, down from the \$40.0 million per year that could possibly be achieved under current law.

The provision making the tax credits transferable creates a potential fiscal impact in future fiscal years. Tax credits that are not transferable and not refundable require the initial tax credit holder to have sufficient state income tax liability over the allowed redemption time frame, to benefit fully from the tax credit. So it is possible that without transferability, some investors may not be able to fully redeem all tax credits acquired. Once a tax credit becomes transferrable or refundable, it can be assumed that all tax credits from that program will be redeemed within the allowed redemption period.

If it is assumed that 10.0% of the tax credits issued under the program will never be redeemed due to the lack of refundability or transferability, then the maximum annual fiscal impact of this provision is \$800,000 per year. Because credits acquired through this program cannot be redeemed for three tax years after the investment is made, any impact associated with making the credits transferable will not occur until at least FY 2015.

## **Source**

Iowa Economic Development Authority

---

/s/ Holly M. Lyons

April 24, 2012

---

The fiscal note for this bill was prepared pursuant to [Joint Rule 17](#). Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.

---